In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-981

GEORGE C. McGEE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The sole question presented by the petitioner in this federal income tax case is whether petitioner's tax returns for 1957 through 1963, which failed to report substantial "kickbacks" received by him, were false and fraudulent with the intent to evade tax, so as to lift the bar of the statute of limitations that would otherwise have been applicable in accordance with Section 6501(c)(1) and (2) of the Internal Revenue Code of 1954 (26 U.S.C.), and to require the imposition of the 50 percent fraud penalty prescribed by Section 6653(b).

The pertinent facts are as follows: During the years in issue, petitioner was employed by Gulf Oil Corporation as its port engineer in Port Arthur, Texas. Petitioner had the duty of arranging for, and overseeing, the performance of maintenance and repairs on Gulf's ships, tankers, barges and other vessels in the Gulf Coast area. In that capa-

city he employed Port Arthur Marine Engineering Works ("Marine") and Gulf Copper Manufacturing Company ("Copper") to perform work for Gulf (Pet. App. B-3).

At petitioner's request, and with the cooperation of Marine's president, Marine submitted invoices to Gulf that contained either in whole or in part charges for services not actually performed. The invoices were approved for payment by petitioner, and then paid by Gulf by checks made payable to Marine, which deposited the checks in its general bank account. Marine would then pay to petitioner a previously arranged portion, ranging from 5 to 50 percent, of each remittance. The payments to petitioner were made sometimes by cash paid to petitioner in the office of Marine's president, sometimes by Marine's check payable to petitioner, and sometimes by Marine's check made payable to its president and by him endorsed either to petitioner or for deposit in petitioner's bank account (Pet. App. B-3 to B-4).

Petitioner did not report on his income tax returns any of the payments received from Marine during the years in issue. When questioned by a revenue agent during an audit of his returns for those years, petitioner denied that he had received any funds from Marine not reported on his returns (Pet. App. B-4 to B-5).

During the years in issue, petitioner also received payments from Copper as a condition of that firm's doing business with Gulf. However, Copper did not inflate its invoices to Gulf, and reported its payments to petitioner on Treasury Forms 1099. Petitioner reported those payments on his income tax returns for the years in question (Pet. App. B-5).

The Commissioner asserted deficiencies in petitioner's federal income taxes for the years 1957 through 1963 by

virtue of the omission of the kickback payments from Marine, and asserted also the 50 percent fraud penalty imposed by Section 6653(b) of the Internal Revenue Code. The Tax Court found that the kickback payments from Marine constituted taxable income to petitioner for the years 1957 through 1963, and found also that the Commissioner had borne his burden of proving that the returns were fraudulent, thus removing the bar of the statute of limitations that would otherwise have been applicable to the years prior to 1963 and sustaining the imposition of the 50 percent fraud penalty (Pet. App. B-1 to B-21). The court of appeals affirmed (Pet. App. A-1 to A-10).

1. Relying upon *James* v. *United States*, 366 U.S. 213, petitioner argues (Pet. 3-6) that his omission of kickback payments prior to the decision in *James* could not have been fraudulent. But neither *James* nor the case it overruled, *Commissioner* v. *Wilcox*, 327 U.S. 404, supports petitioner's contention, because they dealt only with the taxability of the proceeds of embezzlement. In *Wilcox*, this Court had ruled that embezzled funds did not constitute gross income. However, in *Rutkin* v. *United States*, 343 U.S. 130, the Court held that the proceeds of extortion did constitute gross income, and, with respect to *Wilcox*, stated (343 U.S. at 138): "We limit that case to its facts." Then, in *James*, a criminal prosecution for willful attempts to evade tax, the Court explicitly overruled *Wilcox* and held that embezzled funds did constitute gross income, but further held (366 U.S. at 221-222) that the felony conviction for willful attempts to evade tax could not be sustained on the basis of failure to report embezzled funds during years in which *Wilcox* was extant.

Quite apart from the fact that no criminal penalty is here involved,[1] this Court and the lower courts, long prior to *James*, had not treated *Wilcox* as extending beyond the case of the embezzlement of funds. As this Court noted in *James* (366 U.S. at 217-218), the courts of appeals had consistently held prior to *James* that funds derived from kickbacks, frauds, and swindles were to be differentiated from embezzled funds, and were to be excluded from gross income by virtue of the *Wilcox* decision.[2] Thus, whatever uncertainty may have existed prior to *James* with respect to the inclusion of embezzlement proceeds in gross income, there was no question that kickbacks, such as those received by petitioner, are taxable.

2. Petitioner's assertion (Pet. 10-12) that the Tax Court erred by failing to require that the Commissioner prove fraud on the part of petitioner, and that the court of appeals overlooked this asserted error, is not borne out by the record. The Tax Court (Pet. App. B-18 to B-20) acknowledged that the Commissioner had the burden of proving fraud and carefully reviewed the evidence of fraud. This was not limited to the fact that petitioner had

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[1] Two courts, in decisions invoked by petitioner (Pet. 6-7), have, with respect to embezzled funds, extended *James* to hold that civil fraud penalties could not be imposed for a failure to report embezzled funds as income during years prior to the *James* decision. *Kahr* v. *Commissioner*, 414 F.2d 621 (C.A. 2); *Adame's Estate* v. *Commissioner*, 320 F.2d 811 (C.A. 5). The other cases invoked by petitioner were criminal cases following *James*.

[2] See, *e.g.*, *Akers* v. *Scofield*, 167 F.2d 718 (C.A. 5); *Briggs* v. United States, 214 F.2d 699 (C.A. 4), certiorari denied, 348 U.S. 864; *Berra* v. *United States*, 221 F.2d 590 (C.A. 8), affirmed, 351 U.S. 131; *United States* v. *McGuire*, 347 F.2d 99 (C.A. 6), certiorari denied, 382 U.S. 826. The Fifth Circuit in 1942 had anticipated the *Wilcox* decision with respect to the proceeds from embezzlement in *McKnight* v. *Commissioner*, 127 F.2d 572, but that court, still prior to *Wilcox*, had differentiated kickbacks obtained in circumstances closely parallel to the present case, and in *Caldwell* v. *Commissioner*, 135 F.2d 488, held such kickbacks taxable.

consistently failed to report substantial amounts of kickbacks as income over the seven-year period. Petitioner's acknowledged and elaborately contrived fraud upon his employer gave rise to an inference that he would not hesitate to misrepresent and conceal receipt of the fraudulently derived funds from the government with intent to evade tax.

Petitioner maintained no records of his receipts from Marine, and the facts and circumstances of unidentifiable cash payments concealed the transactions to such an extent that the amount of cash received was still uncertain. However, petitioner reported the kickbacks he received from Copper, because he knew they had been reported to the Treasury, but did not report the kickbacks from Marine, even during the years after the *James* decision removed the highly attentuated justification that he asserts for failure to report them. Finally, petitioner denied to a revenue agent that he had received unreported payments from Marine.

Reviewing all of these facts, the Tax Court was justified in concluding (Pet. App. B-20) that the Commissioner had carried his burden of proving fraud. Under these circumstances, the court of appeals (Pet. App. A-8) correctly held that the Tax Court's finding was not clearly erroneous and that "the result reached is far from being contrary to the truth and right of the case."

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

FEBRUARY 1976.

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